

a qualified residence of the tenant-shareholder, any amount allowable as a deduction to the tenant-stockholder under section 216(a)(2) is qualified residence interest.

(4) *Special rule to prevent tax avoidance.* If the amount treated as qualified residence interest under this section exceeds the amount which would be so treated if the tenant-stockholder were treated as directly owning his proportionate share of the assets and liabilities of the cooperative and one of the principal purposes of the cooperative arrangement is to permit the tenant-stockholder to increase the amount of qualified residence interest, the district director may determine that such excess is not qualified residence interest.

(5) *Other definitions.* For purposes of this section, the terms “tenant-stockholder,” “cooperative housing corporation” and “proportionate share” shall have the meaning given by section 216 and the regulations thereunder.

(r) *Effective date.* The provisions of this section are effective for taxable years beginning after December 31, 1986.

[T.D. 8168, 52 FR 48410, Dec. 22, 1987]

§ 1.163-12 Deduction of original issue discount on instrument held by related foreign person.

(a) *General rules—(1) Deferral of deduction.* Except as provided in paragraph (b) of this section, section 163(e)(3) requires a taxpayer to use the cash method of accounting with respect to the deduction of original issue discount owed to a related foreign person. A deduction for an otherwise deductible portion of original issue discount with respect to a debt instrument will not be allowable as a deduction to the issuer until paid if, at the close of the issuer's taxable year in which such amount would otherwise be deductible, the person holding the debt instrument is a related foreign person. For purposes of this section, a related foreign person is any person that is not a United States person within the meaning of section 7701(a)(30), and that is related (within the meaning of section 267(b)) to the issuer at the close of the taxable year in which the amount incurred by the taxpayer would other-

wise be deductible. Section 267(f) defines “controlled group” for purposes of section 267(b) without regard to the limitations of section 1563(b). An amount is treated as paid for purposes of this section if the amount is considered paid for purposes of section 1441 or section 1442 (including an amount taken into account pursuant to section 871(a)(1)(C), section 881(a)(3), or section 884(f)). The rules of this paragraph (a) apply even if the original issue discount is not subject to United States tax, or is subject to a reduced rate of tax, pursuant to a provision of the Internal Revenue Code or a treaty obligation of the United States. For purposes of this section, original issue discount is an amount described in section 1273, whether from sources inside or outside the United States.

(2) *Change in method of accounting.* A taxpayer that uses a method of accounting other than that required by the rules of this section must change its method of accounting to conform its method to the rules of this section. The taxpayer's change in method must be made pursuant to the rules of section 446(e), the regulations thereunder, and any applicable administrative procedures prescribed by the Commissioner. Because the rules of this section prescribe a method of accounting, these rules apply in the determination of a taxpayer's earnings and profits pursuant to § 1.312-6(a).

(b) *Exceptions and special rules—(1) Effectively connected income.* The provisions of section 267(a)(2) and the regulations thereunder, and not the provisions of paragraph (a) of this section, apply to an amount of original issue discount that is income of the related foreign person that is effectively connected with the conduct of a United States trade or business of such related foreign person. An amount described in this paragraph (b)(1) thus is allowable as a deduction as of the day on which the amount is includible in the gross income of the related foreign person as effectively connected income under sections 872(a)(2) or 882(b) (or, if later, as of the day on which the deduction would be so allowable but for section 267(a)(2)). However, this paragraph (b)(1) does not apply if the related foreign person is exempt from United

States income tax on the amount owed, or is subject to a reduced rate of tax, pursuant to a treaty obligation of the United States (such as under an article relating to the taxation of business profits).

(2) *Certain obligations issued by natural persons.* This section does not apply to any debt instrument described in section 163(e)(4) (relating to obligations issued by natural persons before March 2, 1984, and to loans between natural persons).

(3) *Amounts owed to a foreign personal holding company, controlled foreign corporation, or passive foreign investment company—(i) Foreign personal holding companies.* If an amount to which paragraph (a) of this section otherwise applies is owed to a related foreign person that is a foreign personal holding company within the meaning of section 552, then the amount is allowable as a deduction as of the day on which the amount is includible in the income of the foreign personal holding company. The day on which the amount is includible in income is determined with reference to the method of accounting under which the foreign personal holding company computes its taxable income and earnings and profits for purposes of sections 551 through 558. See section 551(c) and the regulations thereunder for the reporting requirements of the foreign personal holding company provisions (sections 551 through 558).

(ii) *Controlled foreign corporations.* If an amount to which paragraph (a) of this section otherwise applies is owed to a related foreign person that is a controlled foreign corporation within the meaning of section 957, then the amount is allowable as a deduction as of the day on which the amount is includible in the income of the controlled foreign corporation. The day on which the amount is includible in income is determined with reference to the method of accounting under which the controlled foreign corporation computes its taxable income and earnings and profits for purposes of sections 951 through 964. See section 6038 and the regulations thereunder for the reporting requirements of the controlled foreign corporation provisions (sections 951 through 964).

(iii) *Passive foreign investment companies.* If an amount to which paragraph (a) of this section otherwise applies is owed to a related foreign person that is a passive foreign investment company within the meaning of section 1296, then the amount is allowable as a deduction as of the day on which amount is includible in the income of the passive foreign investment company. The day on which the amount is includible in income is determined with reference to the method of accounting under which the earnings and profits of the passive foreign investment company are computed for purposes of sections 1291 through 1297. See sections 1291 through 1297 and the regulations thereunder for the reporting requirements of the passive foreign investment company provisions. This exception shall apply, however, only if the person that owes the amount at issue has made and has in effect an election pursuant to section 1295 with respect to the passive foreign investment company to which the amount at issue is owed.

(c) *Application of section 267.* Except as limited in paragraph (b)(1) of this section, the provisions of section 267 and the regulations thereunder shall apply to any amount of original issue discount to which the provisions of this section do not apply.

(d) *Effective date.* The rules of this section are effective with respect to all original issue discount on debt instruments issued after June 9, 1984.

[T.D. 8465, 58 FR 236, Jan. 5, 1993; 58 FR 8098, Feb. 11, 1993]

§ 1.163-13 Treatment of bond issuance premium.

(a) *General rule.* If a debt instrument is issued with bond issuance premium, this section limits the amount of the issuer's interest deduction otherwise allowable under section 163(a). In general, the issuer determines its interest deduction by offsetting the interest allocable to an accrual period with the bond issuance premium allocable to that period. Bond issuance premium is allocable to an accrual period based on a constant yield. The use of a constant yield to amortize bond issuance premium is intended to generally conform the treatment of debt instruments having bond issuance premium with those